

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:FS:MAN:2:POSTF-167498-01

JSRubinstein

date:

12/27/01

to: Richard Fleming, Territory Manager, Technology,
Communication and Media
Attn: IRS Team Coordinator [REDACTED]

from: Area Counsel, LMSB (Financial Services)

subject:

[REDACTED]
Tax Year Ended: [REDACTED]
Statute of Limitations Expires: [REDACTED]

UIL No. 6231.01-01

This memorandum responds to your request for our assistance dated December 13, 2001, in determining whether [REDACTED] a partnership whose partners are subsidiaries of [REDACTED] [REDACTED] qualifies as a small partnership and is, therefore, excluded from the TEFRA provisions of the Internal Revenue Code. This memorandum should not be cited as precedent. This issue was discussed with Mr. William A. Heard of Administrative Procedure Judicial Practice, Branch 3 in the National Office who agrees that [REDACTED] qualifies as a small partnership for the year ended December 31, [REDACTED]. The advice rendered in this memorandum is conditioned on the accuracy of the facts presented to us. This advice is subject to National Office review. We will contact you within two weeks of the date of this memorandum to discuss the National Office's comments, if any, about this advice.

Issue

Whether [REDACTED], a partnership having a domestic corporate partner and a foreign corporate partner, qualifies for the small partnership exception to the TEFRA audit provisions pursuant to I.R.C. § 6231(a)(1) for the year ending December 31, [REDACTED]?

Conclusion

██████████ qualifies for the small partnership exception to the TEFRA audit provisions pursuant to I.R.C. § 6231, for the tax year ended December 31, ██████████, since it has ten or fewer partners each of whom is an individual, C corporation or an estate of a deceased partner, and the partnership did not affirmatively elect to be governed by TEFRA.

Facts

The Service is currently examining the Consolidated Federal Income Tax Returns, Form 1120, for [REDACTED] ("[REDACTED]") for the tax years ended December 31, [REDACTED] through December 31, [REDACTED], inclusive.

(b) (7)(C), filed a U.S. Partnership Return of Income, Form 1065, for the tax years ended December 31, 1984 through December 31, 1985. The partnership return for 1984 for the year ended December 31, 1984 indicated that as of December 31, 1984, [REDACTED], Inc., a domestic corporation had a [REDACTED] % ownership interest in [REDACTED] and that [REDACTED], a foreign corporation had a [REDACTED] % ownership interest in [REDACTED]. [REDACTED], Inc., a domestic corporation had a [REDACTED] % interest in [REDACTED] at the beginning of the 1984 tax year. In addition, [REDACTED] did not affirmatively elect to be governed by the TEFRA audit provisions on the partnership return filed for the tax year ended December 31, 1984. Both [REDACTED], Inc. and [REDACTED] are subsidiaries of [REDACTED], therefore, the income and deductions for [REDACTED] are included in the Consolidated Federal Income Tax Return, Form 1120, for [REDACTED] in all audit years. The partnership return for [REDACTED] is being examined for the tax year ending December 31, 1985 only.

You have requested our assistance in determining whether [REDACTED] qualifies as a "small partnership" under I.R.C. § 6231 and is, therefore, excepted from the TEFRA audit provisions for the year ended December 31, [REDACTED].

Law & Analysis

In 1982 the Tax Equity & Fiscal Responsibility Act of 1982 (TEFRA) added to the Internal Revenue Code the unified partnership audit procedures, which provide administrative rules for the auditing of a partnership return and its partners.

For the purpose of the unified partnership audit rules, I.R.C. § 6231 provides an exception from the definition of a partnership for certain "small partnerships." A small partnership is defined as "any partnership having 10 or fewer partners each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner. For purposes of the proceeding sentence, a husband and wife (and their estates) shall be treated as 1 partner." See I.R.C. § 6231(a)(1)(B)(i).

In 1997, P.L. 105-34, Sec. 1234(a) (applicable to partnerships with taxable years ending after 8/5/97), expanded I.R.C. § 6231 (a)(1)(B)(i) to allow partnerships having ten or fewer C corporations as partners in the partnership to be excluded from the TEFRA audit provisions. Therefore, effective for tax years ending after August 5, 1997, the small partnership exception to the TEFRA audit provisions is available to a partnership having 10 or fewer C corporations as partners.

A small partnership within the meaning of I.R.C. § 6231(a)(1)(B)(i) can elect to have the small partnership exception not apply. Such election shall apply for such taxable year and all subsequent taxable years unless revoked with the consent of the Secretary. See I.R.C. § 6231(1)(1)(B)(ii).

Section 301.6231(a)(1)-1(a)(1) of the Regulations clarifies the small partnership exception and states:

The 10 or fewer limitation described in section 6231(a)(1)(B)(i) is applied to the number of natural persons, C corporations, and estates of deceased partners that were partners at any one time during the partnership taxable year. Thus, for example, a partnership that at no time during the taxable year had more than 10 partners may be treated as a small partnership even if, because of transfers of interests in the partnership, 11 or more natural persons, C corporations, or estates of deceased partners owned interests in the partnership for some portion of the taxable year. See section 1361(a)(2) for the definition of a C corporation. For purposes of section 6231(a)(1)(B) and this section, a husband and wife (and their estates) are treated as one person.

Furthermore, § 301.6231 (a)(1)-1(a)(3) of the Regulations provides that the determination of whether a partnership meets the qualifications for the exception for small partnerships is made annually and states:

Determination made annually. The determination of whether a partnership meets the requirements for the exception for small partnerships under section 6231(a)(1)(B) and this paragraph (a) shall be made with respect to each partnership taxable year. Thus, a partnership that does not qualify as a small partnership in one taxable year may qualify as a small partnership in another taxable year if the requirements for the exception under section 6231(a)(1)(B) and this paragraph (a) are met with respect to that other taxable year.

Finally, § 301.6231(a)(1)-1(a)(3)(b) of the Regulations provides that any partnership that meets the requirements set forth in section 6231(a)(1)(B) and paragraph (a) of section 6231 (relating to the exception for small partnerships) may elect under paragraph (b)(2) of section 6231 to have the provisions of subchapter C of chapter 63 of the Internal Revenue Code apply.

Section 301.6231(a)(1)-1(a)(1) of the Regulations adopt the definition of a C corporation found in I.R.C. § 1361(a)(2), which states that the term "C corporation" means, with respect to any taxable year, a corporation which is not an S corporation for such year.

The partnership return for [REDACTED] for the year ended December 31, [REDACTED] indicated that the partnership had one domestic corporate partner and one foreign corporate partner as of December 31, [REDACTED]. [REDACTED] qualifies as a small partnership and is, therefore, excepted from the provisions of TEFRA since it has 10 or fewer partners each of who is an individual, C corporation or an estate of a deceased partner. Although [REDACTED] has a foreign corporate partner, the Regulations adopt the definition of "C corporation" found in I.R.C. § 1361(1)(2), which defines a C corporation as any corporation which is not an S corporation. Under this definition, a foreign corporation will be treated as a C corporation even if it is not taxed under Subtitle C. Furthermore, a foreign corporation is not an "individual" who is a nonresident alien.

[REDACTED] qualifies for the small partnership exception to the TEFRA provisions pursuant to I.R.C. § 6231, for the tax year ended December 31, [REDACTED], since [REDACTED] did not affirmatively elect to be governed by TEFRA.

Should you have any questions regarding this matter, please contact Jody Rubinstein of this office at (212) 436-1483.